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No. .....
IN THE

Supreme Court of the United States

October Term, 1980

LOYD S. DRENNAN,

Petitioner,

vs.

SECURITY PACIFIC NATIONAL BANK,

Respondent.

Petition for Writ of Certiorari to the Supreme Court for the State of California.

YOUNG, WOOLRIDGE, PAULDEN, SELF, FARR & HUGIE,
DAVID R. GRIFFIN,
1675 Chester Avenue, 4th Floor,
Bakersfield, Calif. 93301,
(805) 327-9661,
Attorneys for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Loyd S. Drennan, the petitioner herein, prays that a Writ of Certiorari issue to review the judgment of the Supreme Court of California entered in the above-entitled case on January 22, 1981.

Questions Presented.

1. Did 15 U.S.C. §1610, *et seq.*, (The Truth in Lending Act) and 12 C.F.R. §226, *et seq.*, (Regulation Z) preempt application of state common law requiring additional but not contradictory disclosure of consumer credit contract terms?

2. Did the California Supreme Court err in failing to comply with the administrative procedure established by 12 C.F.R. §226, *et seq.*?

3. Would the California Supreme Court opinion require an interpretation of the Truth in Lending Act and Regulation Z which is violative of the 5th and 14th Amendment of the Constitution of the United States?

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LOYD S. DRENNAN,

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vs.

SECURITY PACIFIC NATIONAL BANK,

Respondent.

Petition for Writ of Certiorari to the Supreme Court for the State of California.

Opinions Below.

The Opinion of the California Supreme Court dated January 22, 1981, is reported at 28 Cal.3d 764 and is printed in Appendix "A" hereto.

Jurisdiction.

The judgment of said Court was entered on January 22, 1981. The jurisdiction of the Supreme Court is invoked pursuant to 28 U.S.C. §1257(c) which provides:

> "By writ of certiorari, where the validity of a treaty or statute of the United States is drawn in question or where the validity of a State statute is drawn in question on the ground of its being repugnant to the Constitution, treaties or laws of the United States, or where any title, right, privilege or immunity is specially set up or

claimed under the Constitution, treaties or statutes of, or commission held or authority exercised under, the United States."

Statute and Regulations Involved.

Section 1610 of the Truth in Lending Act (15 U.S.C. §1610) states:

"(a) this subchapter does not annul, alter, or affect, or exempt any creditor from complying with, the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter or regulations thereunder, and then only to the extent of the inconsistency.

***

(d) Except as specified in sections 1635 and 1640 of this title, this subchapter and the regulations issued thereunder do not affect the validity or enforceability of any contract or obligation under State or Federal law."

12 C.F.R. §226.6(b) (a regulation promulgated under the authority of the Truth in Lending Act by the Federal Reserve Board known as Regulation Z) provides:

"(b) Inconsistent State requirements. With respect to disclosures required by this part, State law is inconsistent with the requirements of the Act [section 1601 *et seq.* of this title] and this part, within the meaning of section 111(a) of the Act [section 1610(a) of this title], to the extent that it:

(1) Requires a creditor to make disclosures different from the requirements of this part with respect to form, content, terminology, or time of delivery;

(2) Requires disclosure of the amount of the finance charge determined in any manner other than that prescribed in §226.4; or

(3) Requires disclosure of the annual percentage rate of the finance charge determined in any manner other than that prescribed in §226.5."

12 C.F.R. §226.28(a) provides in pertinent part:

"(a) *Inconsistent disclosure requirements.*

(1) State law requirements that are inconsistent with the requirements contained in chapter 1 (General provisions), chapter 2 (Credit transactions), or chapter 3 (Credit advertising) of the act and the implementing provisions of this regulation are preempted to the extent of the inconsistency. A state law is inconsistent if it requires a creditor to make disclosures or take actions that contradict the requirements of the federal law. A state law is contradictory if it requires the use of the same term to represent a different amount or a different meaning than the federal law, or if it requires the use of a term different from that required in the federal law to describe the same item. A creditor, state, or other interested party may request the Board to determine whether a state law requirement is inconsistent. After the Board determines that a state law is inconsistent, a creditor may not make disclosures using the inconsistent term or form."

Statement of the Case.

On June 5, 1974, petitioner, LOYD S. DRENNAN, purchased a mobilehome in San Luis Obispo County, California, for $25,964.00. The purchase was financed through the respondent, SECURITY PACIFIC NATIONAL BANK, hereinafter referred to as "SECURITY PACIFIC", and entered into a finance agreement by executing SECURITY PACIFIC'S standard form written contract and security agreement. The contract was executed by the mobilehome seller and was immediately assigned to SECURITY PACIFIC.

Pursuant to this agreement, LOYD DRENNAN borrowed $21,721.00 to be repaid in 180 equal installments of $277.56 each, which sum included an interest payment at the rate of 12.98% per annum. The contract called for a total finance charge of $27,797.60 to be paid over the anticipated 15-year term of the loan. The agreement entitled "Conditional Sale Contract — Mobile Home, Recreational Vehicle" contained the following provision:

> "*Prepayment.* In the event buyer prepays the indebtedness hereunder in full prior to maturity, buyer is entitled to a refund of the unearned portion of the finance charge computed in accordance with the 'Rule of 78's' except that no refund of less than $1.00 shall be made."

This method of disclosure was adequate by virtue of the Truth in Lending Act pursuant to 12 C.F.R. §226.8(b)(7) (printed herein for convenience in Appendix "B" and California Consumer Credit Disclosure Statutes which incorporated by reference 12 C.F.R. §226.8(b)(7) (California Civil Code §2981, *et seq.*).

In May of 1977 the petitioner, upon deciding to sell his mobilehome, contacted SECURITY PACIFIC as to the exact amount required to pay off the loan in full. He was advised by letter on May 18, 1977, that the amount required to repay the loan in full was $22,306.79 as of said date. Thus, after making payments for almost three years totaling $9,714.60, petitioner was informed that the payoff on his loan of $21,721.00 was $22,306.79.

At page 3, line 1, of his Complaint, petitioner alleged that the "prepayment" clause is vague, ambiguous and uncertain in that it failed to advise petitioner that a prepayment penalty will be charged in the event of prepayment and to explain or define the "Rule of 78's" and what amount, if any, will be charged in the event of prepayment.

Petitioner's Complaint did not attack the legality of the use of the "Rule of 78's" method. The use of the Rule was expressly approved by Federal and State statute. Petitioner did not claim any violation of the Truth in Lending Act or any State Consumer Credit Enactment.

Petitioner's Complaint was based solely on the alleged violation of fundamental common law contract doctrine developed by the State Common Law in California known as the Adhesion Contract Doctrine. At its essence, petitioner's Complaint alleged that there was no meeting of the minds under the language and circumstances of the contract which would allow the bank to enforce its unexpressed intention to exact a penalty charge in the event of prepayment. The respondent bank demurred.

After the trial court sustained respondent's demurrer without leave to amend, petitioner's appeal ensued to conclusion in the California Supreme Court.

Reasons for Granting the Writ.

There now exist in the United States millions of installment sale contracts which have been executed under the ambit of the Truth in Lending Act.

It was the object of the Act to "assure meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit". (15 U.S.C. §1601.)

This same Act is being used by the respondent bank and hundreds of others to prevent meaningful disclosure of credit terms and to mandate the uninformed use of credit.

As Congress retreats from the scant protections provided by the Act under the guise of deregulation (12 U.S.C. §3501, *et seq.*) the consumer must rely upon the protection

of state law afforded by stricter and more effective disclosure requirements.

The California Supreme Court has decided on the basis of an unofficial staff opinion letter that it is precluded and preempted by the Truth in Lending Act and Regulation Z from applying state common law which would prevent the enforcement of contract provisions where there has not been sufficient disclosure to create a contract.

The unofficial staff letter and the court's opinion based upon it were flatly contrary to the official Federal Reserve Board interpretation which was issued subsequent to the court's ruling. The Board has determined that state disclosure requirements which are more strict than those provided by the Truth in Lending Act and Regulation Z are nonetheless viable and not preempted unless such requirements "contradict" the federal disclosures. In so doing, the Board announced its interpretation of Congress' intent as originally expressed in the Act.

In the Drennan opinion, the California Court has created a rule of federal preemption which is contrary to the interpretation of the Board. It creates a rule which exists only in California and is out of step with the federal scheme of consumer credit regulation in both substance and procedure.

ARGUMENT.

I.

The Truth in Lending Act and Regulation Z Do Not Preempt Stricter State Disclosure Requirements.

At the heart of petitioner's cause of action is the fact that the contract provision complained of and set forth hereinabove fails to give even the vaguest hint of the real economic consequences of prepayment.

It must be noted that the provision speaks of a "refund". It says nothing about a charge or penalty.

The California Supreme Court in the instant case, concluded that the provision amounts to a hidden charge or penalty: "In sum the 'Rule of 78's' is a hidden charge, the operation of which is neither revealed to nor understood by the borrower, and it is a charge burdensome to the consumer and unjustified by the economic needs of the lender."

The court observed that this unpleasant surprise results in the exaction of an estimated $112 million dollars, a year in overcharges by banks.

This prepayment charge can distort the annual percentage rate by more than three percent.

The Federal Reserve Board and the courts have examined the ambiguity of provisions like that in Mr. Drennan's contract and the unfair result it creates. These decisions have invariably involved action based upon the validity of contracts pursuant to the Truth in Lending Act or Federal Reserve Board Regulations.

The Federal Reserve Board issued a regulation cited at 12 C.F.R. §226.8(b)(7) and printed herein as Appendix "B" which allows the mere reference to the "Rule of 78's" as a sufficient disclosure of the method of calculating the prepayment rebate, without requiring as a requisite of the

Truth in Lending Act or Regulation Z a definition, explanation, example or warning of how the Rule of 78's worked or what its consequences were.

In *Bone v. Hibernia Bank* (9th Cir. 1974) 493 F.2d 135, the court of appeal upheld the discretion of the Board but stated:

> " 'Identification' could mean, as the district court held, that the method of rebating unearned interest must be one which is understood by the average borrower, in order that it in fact be 'identified'. Simple reference to the Rule of 78's does not serve this function, for we daresay that its meaning is known to virtually no credit consumers. As the district court stated, 'There must be a recognized nexus between the words used and some acceptable referent, or else the words used are at large and divorced from both reality and meaning'."

Upon review of petitioner's appeal, the California Supreme Court concluded that it was preempted by 15 U.S.C. §1610 and 12 C.F.R. §226.6(b) from applying the state common law doctrine of Adhesion Contract. This judicially developed doctrine of fundamental contract law would have prevented the bank from enforcing the provision complained of. The ambiguity inherent in the provision of the contract, executed in circumstance of disparate bargaining power between the consumer and the bank, prevented a meeting of minds.

The issue rested upon the court's interpretation of the meaning of the term inconsistent as used in 15 U.S.C. §1610.

While the issue was the subject of intense briefing and argument, it was essentially a matter of first impression since no official Federal Reserve Board interpretation or court ruling had issued on the subject.

Petitioner relied upon *Mason v. Gen. Finance* (4th Cir. 1976) 542 F.2d 1226, 1234, which determined:

> "The congress clearly did not preempt the field. Not only is the substantive law of the state preserved in tact as to the rates of charges but even disclosure of information in connection with credit transactions required by state law is specifically protected by the federal statute, except to the extent that those laws are inconsistent with the provisions (of the Consumer Credit Protection Act) or regulations thereunder and then only to the extent of the inconsistency." (15 U.S.C. §1610(a).) "It is our federalism and congressional respect for it that occasions the difficulty in this case. Our problem then is how to accord supremacy to federal law and at the same time honor the provisions of state law in accordance with the congressional directive".

Respondents relied upon an unofficial staff interpretive letter which was submitted to court by letter dated October 2, 1980.

The letter expressed a belief by one staff member that a state requirement that the bank define, explain, or warn of the consequences of prepayment provisions would probably be preempted. Respondents asked that this unofficial interpretation be given the deference of a staff interpretation of the Federal Reserve Board issued pursuant to its interpretive responsibility under 12 C.F.R. §226.1(d). The court, citing *Ford Motor Credit Company v. Milhollin* (1980) 100 S.Ct. 790, expressly relied upon this unofficial letter in its opinion.

If it were not clear from the face of 15 U.S.C. §1610 and 12 C.F.R. §226.6(b) that stricter state disclosure requirements were not preempted unless they "contradicted" federal disclosures, the Federal Reserve Board issued an official interpretive regulation at 12 C.F.R. §226.28 which makes this proposition irrefutable and the California

Supreme Court's opinion herein irreconcilable with the Truth-in-Lending Act.

As this court has so often stated, the interpretation of the Federal Reserve Board should be given great weight when it interprets a Congressional directive, and in particular the Truth in Lending Act.

The ruling of the California Supreme Court has created a rule which is followed nowhere else in the Union. It is inconsistent and irreconcilable with the federal-state consumer credit scheme. It has abdicated power to the federal government where none was sought.

II.

The California Supreme Court Failed to Comply With Federal Administrative Procedure.

15 U.S.C. §1610 and §1633 and 12 C.F.R. §226.6 establish a procedure whereby the Federal Reserve Board is given the power and procedure to determine whether there is an inconsistency between a state disclosure requirement and the Truth in Lending Act. Further, the Board is empowered to grant by regulation an exemption to a state from complying with the provisions of the Act.

Such determinations are to be made by the Board pursuant to the procedure established by the Board's Rules of Procedure (12 C.F.R. §262) and the Federal Administrative Procedure Act.

This procedural scheme affords petitioner all of the protections afforded by the Acts, including the right to notice, the right to be heard, rights to access to records and other essential rights.

The procedural scheme also assures that interpretations of the Truth in Lending Act and the application of its provisions are consistent and uniform within the framework of the federal-state constitutional structure.

The California Supreme Court's precipitous action in preempting itself cut off petitioner's vital procedural rights. Without an announcement of the California common law requirement, neither petitioner, respondent nor any interested party can seek the interpretation of the Federal Reserve Board.

Should this Honorable Court reverse the judgment of the California court, petitioner will be entitled to a decision on the merits of his contention that state common law affords him protection from the hidden charge imposed by the subject prepayment provision. The Supreme Court of California refused to decide the issue by stating:

> "Whether or not the use of a term which the drafter of the contract knows to be intelligible to the weaker party invokes the law relating to adhesion contracts we need not reach because we conclude this court is prohibited by federal law from requiring that a lender explain the meaning of the words in question." (*Drennan, supra*, at 770.)

We request that this Honorable Court direct the California court to answer the question under state law and allow for the operation of the federal administrative procedure.

III.

The California Supreme Court's Decision Would Require an Interpretation of the Truth in Lending Act Which Would Violate the 5th Amendment.

If state common law, which would provide a definition, explanation or warning of the consequences of the subject contract provision were precluded by the Truth in Lending Act then a contract provision such as the one in Mr. Drennan's contract which contains no definition, explanation or warning of the consequences of the prepayment provision would be approved, if not mandated, by federal law.

In fact, in the instant case respondents have argued that federal law mandates the disclosure of the prepayment "rebate" in the manner done so in respondent's contract.

If state law requirements were not allowed to intercede and provide the consumer with the information needed he would have no notice of the intention of the bank to take a "hidden charge or penalty" in the event of prepayment.

Such a private action to collect such a hidden charge under the authority of the federal regulation and by virtue of the enforcement of such a contract right in the courts of the United States or a state would constitute a deprivation of property without due process of law in violation of the 5th Amendment.

Conclusion.

The California Supreme Court has been misled by respondents to believe that the Federal Reserve Board has interpreted the Truth in Lending Act to preempt any disclosure other than those required by Regulation Z. The Federal Reserve Board has made clear the congressional intention originally expressed in the Act.

The decision of the California Supreme Court cannot be reconciled with the Board's regulation and the court must act to establish a uniform rule on the substantive and procedural issues raised herein.

The Banks cannot be allowed to use the Truth in Lending Act which was intended at its inception to protect the consumer and provide him with information to preclude the application of state law which would operate to accomplish this same end.

Respectfully submitted,

YOUNG, WOOLRIDGE, PAULDEN, SELF,
FARR & HUGIE,
DAVID R. GRIFFIN,
Attorneys for Petitioner.

APPENDIX A.

In the Supreme Court of the State of California.

Loyd S. Drennan, Plaintiff and Appellant v. Security Pacific National Bank, Defendant and Respondent. L.A. 31247, Super. Ct. No. 49108.

Plaintiff, Loyd S. Drennan, purchased a mobile home financed by defendant Security Pacific National Bank (defendant) under a conditional sale contract. The contract provided that if plaintiff repaid the indebtedness prior to maturity, he was entitled to a refund of the unearned portion of the finance charge in accordance with the "Rule of 78's." Plaintiff claims that the contract was an adhesion contract, that the term "Rule of 78's" is ambiguous, and that the prepayment provision is void.

The primary question before us is whether federal law precludes us from requiring that conditional sale contracts provide a definition of that term. As will appear, we answer this question in the affirmative and conclude, in addition, that while a statement in or appended to the contract to alert the borrower that the rule may operate to his disadvantage may be desirable and consistent with federal law, the law governing adhesion contracts does not compel such a warning.

Plaintiff purchased a mobile home on June 5, 1964, at which time he entered into a conditional sale contract with the seller. He financed $21,965 of the purchase price; the finance charge, $27,997.60, was computed at the time the contract was signed, so that the total amount he would be required to pay by the end of the term of the contract was $49,962.60. The contract called for him to pay that sum in 180 monthly installments of $244 each, including interest on the unpaid balance at the rate of 12.98% a year. A clause of the agreement provided that if plaintiff prepaid the in-

debtedness in full prior to maturity, he would be entitled to a refund of the unearned portion of the finance charges "computed in accordance with the 'Rule of 78's'. . . ." The contract was assigned by the seller to defendant.

After making the installment payments called for in the contract for almost three years, plaintiff proposed to sell the mobile home. Defendant notified him that the amount required to pay off the loan was $22,306.79, or $341.79 more than he had originally borrowed, although he had paid more than $9,700 in installment payments in the interim.

Plaintiff filed a complaint for declaratory relief on behalf of himself and others similarly situated, alleging that the contract was an adhesion contract and that the provision regarding prepayment quoted above is vague, ambiguous, and uncertain because it failed to explain or define the term "Rule of 78's" and did not advise him that a "prepayment penalty" would be charged, and the amount thereof. He sought a declaration that the provision was void and unenforceable, and prayed for damages in the amount of the "prepayment penalty" on behalf of the members of the class. The trial court sustained defendant's demurrer without leave to amend, and dismissed the action. Plaintiff appeals from the ensuing judgment.

The operation of the "Rule of 78's" has been explained in a variety of ways; two of these explanations are set forth in the margin.[1] For the purposes of this opinion, it is suf-

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[1]The Civil Code describes the rebate due under the rule by specifying that the "amount of the unearned portion of the finance charge shall be at least as great a proportion of the finance charge . . . as the sum of the periodic monthly time balances payable more than 15 days after the date of prepayment bears to the sum of all the periodic monthly time balances due under the schedule of installments in the contract. . . ." (Civ. Code, § 2982, subd. (e)(1).)

The Commerce Clearing House Consumer Credit Guide employs the following explanation of the operation of the rule:

ficient to observe that under this method of calculating the rebate to a borrower upon repayment of a loan prior to maturity[2] he receives a smaller refund than he would be entitled to if the interest was calculated strictly on the basis of the time he had use of the money. For example, if the prepayment occurs one-third of the way through the term of the loan, the lender retains not one-third of the interest but over 46%. If the refund due the borrower is determined by the actuarial method, which measures the true interest yield, the amount of interest charged would bear a direct relationship to the amount of money used by the borrower and the period during which he had retained it, and the refund would be larger than under the "Rule of 78's." Although the difference between the two methods is insig-

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"In the case of advance payments, many creditors will rebate an unearned finance charge in accordance with the Rule of 78's, also referred to as the sum-of-the-digits method, which works in the following manner:

"On a 12-month repayment plan, the numbers 1 through 12 are added together to provide the figure 78. This becomes a denominator in the calculation. The sum of the months expired at the time of prepayment becomes the numerator. The resulting fraction represents the earned finance charge.

"The first month of a 12-month obligation is considered as 12 because the outstanding balance is 12 times as large during the first month as it is for the last month. The second month is 11, and so an until 1 designates the final month.

"Thus, the portion of the finance charge considered earned after the first month is 12/78 of the entire finance charge. For the second month alone it is 11/78. If prepayment occurs at the end of the second month, the earned finance charge is 23/78 of the total finance charge — 12/78 plus 11/78.

"If prepayment occurs after the 8th month, the amount of earned finance charge will be 68/78 (the sum of 12/78, 11/78 . . . 5/78). Put another way, the rebate will amount to 10/78 of the total finance charge, less any charges that might be deducted from that amount." (CCH Cons. Cred. Guide, Truth-in-Lending, ¶ 1452.)

[2]While we recognize that a conditional sale contract is not a loan and that the finance charge assessed does not constitute interest (Boerner v. Colwell Co. (1978) 21 Cal.3d 37, 45-47), for literary convenience this opinion will not make these distinctions.

nificant on a short-term loan of a relatively small amount,[3] for larger loans of longer duration, the actuarial method results in a substantially larger refund to the consumer.

Plaintiff does not claim that defendant acted illegally by calculating the refund due him under the "Rule of 78's." Indeed, the Rees-Levering Motor Vehicles Sales and Finance Act (Civ. Code, § 2981 et seq.),[4] which governs the terms of conditional sale contracts for automobiles and mobile homes, states that the refund on prepayment may be determined according to the rule (Civ. Code, § 2982, subd. (e)(1)).[5] What plaintiff does contend is that the contract he signed was an adhesion contract and that the term "Rule of 78's" is ambiguous; thus the provision that the amount of rebate on prepayment is to be calculated in accordance with the rule is void.

There can be no doubt that the contract at bar is an adhesion contract, and defendant so concedes.[6] In a contract of adhesion, ambiguous terms will be interpreted against the stronger party and in a manner which would support the

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[3]For a 12-month loan of $1,200, subject to a finance charge of $96, the maximum difference between the rebate required by application of the 'Rule of 78's" and the actuarial method is 71 cents, if the loan is repaid after four months.

[4]Hereinafter called the Rees-Levering Act.

[5]The utilization of the "Rule of 78's" to calculate the rebate under the Rees-Levering Act is authorized where, as here, the finance charge is determined at the outset of the transaction. Although the act has been amended in numerous respects since plaintiff entered into the contract, this opinion will refer to the current version of the statute, unless the amendments have resulted in changes which are relevant to the issues before us.

[6]In Steven v. Fidelity & Casualty Co. (1962) 58 Cal.2d 862, 882, we defined such a contract as a "standardized contract prepared entirely by one party to the transaction for the acceptance of the other; such a contract, due to the disparity in bargaining power between the draftsman and the second party, must be accepted or rejected by the second party on a 'take it or leave it' basis, without opportunity for bargaining and under such conditions that the 'adherer' cannot obtain the desired product or service save by acquiescing in the form agreement."

reasonable expectations of the weaker party. (Gray v. Zurich Insurance Co. (1966) 64 Cal.2d 263, 270-271.)

Defendant urges that the term "Rule of 78's" is not ambiguous because it has a settled meaning. It is true that, unlike other contractual provisions which have been held to be ambiguous (*e.g.*, Estate of White (1970) 9 Cal.App.3d 194, 200; Atchison T. & S. F. Ry. Co. v. Brotherhood R. R. Trainmen (1964) 229 Cal.App.2d 607, 615), the phrase in issue unquestionably has an established meaning. It is equally true, however, that, as is well known to the members of the financial community, including defendant, the average consumer lacks the vaguest notion of what those words mean and that, therefore, the term conveys no information to him regarding the means by which a rebate will be calculated. Whether or not the use of a term which the drafter of the contract knows to be unintelligible to the weaker party invokes the law relating to adhesion contracts we need not reach because we conclude this court is prohibited by federal law from requiring that a lender explain the meaning of the words in question.

We turn, then, to a summary of the laws requiring disclosure of credit terms to consumers. The purpose of such enactments is to assure that a consumer will be in a position to "compare more readily the various credit terms available to him and avoid the uninformed use of credit." (See 15 U.S.C.A., § 1601 et seq.) These provisions are embodied by the federal government in the Truth in Lending Act (hereinafter TILA). TILA provides that state disclosure laws inconsistent with the act are not binding on a creditor. (15 U.S.C.A. § 1610, subd. (a).) In California, the disclosure laws appear in the Rees-Levering Act, and in the Unruh Act (Civ. Code, § 1801 et seq.), which regulates retail installment sales.

The TILA empowers the Federal Reserve Board (Board) to enact regulations to carry out its purposes (15 U.S.C.A., § 1604), and the Board has promulgated detailed rules in Regulation Z (12 C.F.R. Part 226) pursuant to this authorization. The Rees-Levering Act provides that any information required to be disclosed in a conditional sale contract subject thereto may be set forth in the terminology "required or permitted under Regulation Z." (Civ. Code, § 2982, subd. (g).)

Under Regulation Z, a creditor must identify the method of computing any unearned portion of the finance charge in the event of prepayment of an obligation. (12 C.F.R., § 226.8, subd. (b)(7).)[7] In an interpretation of this provision, the Board has determined that if a rebate is made according to the "Rule of 78's" a reference to the rule without explanation of its meaning or operation is sufficient, giving as its reason that an explanation of the rule involves "complex mathematical descriptions which generally cannot be condensed into simple accurate statements, and which if repeated at length on disclosure forms could detract from other important disclosures." (12 C.F.R., §226.818, subd. (c).)

A federal court has upheld the validity of these regulations. In Bone v. Hibernia Bank, (9th Cir. 1974) 493 F.2d 135, a borrower claimed that a lender violated the TILA by failing to explain the operation of the "Rule of 78's." The court acknowledged that the meaning of the rule "is known to virtually no credit consumers" (493 F.2d at p. 139) but held that the Board was empowered to decide that a lender

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[7]The Rees-Levering Act was amended in 1979 to provide that as of January 1, 1981, a contract subject to its terms must identify the method of calculating a rebate on repayment, and that a reference to the "Rule of 78's" constitutes sufficient identification. (Civ. Code, § 2982, subd. (a)13(A).)

should not be required to explain the operation of the rule, and that the Board's reasons for this determination were persuasive.

In reaching its conclusion, the court relied in part upon a statement by the vice chairman of the Board of Governors of the Federal Reserve Board that the Board was unable to find a simple way to explain the rule and that the alternative "would seem to require a lengthy and complicated mathematical statement which . . . would be . . . uninformative to the consumer, and would have the added disadvantage of further complicating the disclosure statement and detracting from other important disclosures." The court went on to say: "[I]t is precisely these kinds of policy decisions about the disclosure statement, requiring the weighing and balancing of the various available choices, that Congress entrusted to the Federal Reserve Board by granting it such broad powers. the conclusions thus reached by the Board are based upon its specialized experience and access to information, which is not likely to come to the attention of a particular judge in a given case." (493 F.2d at p. 140.) The principles stated in *Bone* have been followed in other federal cases. (See, *e.g.*, Gantt v. Com. Loan Co. (8th Cir. 1978) 573 F.2d 520, 524-526; but see Scott v. Liberty Finance Co. (D. Neb. 1974) 380 F.Supp. 475, 479.)

Plaintiff does not challenge the Board's authority to determine that an explanation of the rule is not required, nor does he explictly challenge the Board's reasons for this determination. Rather, he claims that the federal regulations set forth only a minimum standard, and that a state is free to require a definition of the rule under its laws relating to adhesion contracts. He recognizes that state laws inconsistent with the TILA are not binding on creditors (15 U.S.C.A., § 1610, subd. (a)), but relies upon a provision of Regulation Z to the effect that a creditor may supply

explanations in addition to those mandated by the regulation if the additional information does not "confuse the customer . . . or obscure, or detract attention from the information" which must be provided under Regulation Z. (12 C.F.R., § 226.6, subd. (c).)

Plaintiff all but concedes that a detailed mathematical explanation of the operation of the rule would confuse the consumer or obscure other disclosures required by the TILA. He claims, however, that a chart setting forth the amount of rebate due at various times of prepayment or an example of how the rule operates in a typical contract would convey the essential information without doing violence to the intent and purpose of the TILA.

Even if we were to agree that such an explanation would be helpful, we are not free to hold that it is required. The Board's rulings go further than the mere absence of a requirement that the creditor define the rule. The fact that the Board has exercised the authority given to it by Congress to determine that an explanation would be too complicated to be informative and would detract from other important disclosures mandated by Regulation Z constitutes a prohibition of a state-imposed requirement that the rule be defined by way of example or otherwise.

A recent case decided by the United States Supreme Court supports our conclusion. Ford Motor Credit Co. v. Milhollin (1980) 444 U.S. 555, involved the validity of the Board's interpretation of the TILA as not requiring a statement in the loan contract that the creditor has the right to accelerate payment of the entire debt upon the buyer's default. As in *Bone v. Hibernia Bank, supra*, 493 F.2d 135, the high court upheld the Board's discretion in making the ruling, using language which reiterates the broad sweep of the Board's

powers in interpreting the TILA[8] Of particular significance for the problem before us is the following language: "The concept of 'meaningful disclosure' that animates TILA . . . cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . [informational overload].' . . . And striking the appropriate balance is an empirical process that entails investigation into consumer

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[8]The court stated:

"It is commonplace that courts will further legislative goals by filling the interstitial silences within a statute or a regulation. Because legislators cannot foresee all enventualities, judges must decide unanticipated cases by extrapolating from related statutes or administrative provisions. But legislative silence is not always the result of a lack of prescience; it may instead betoken permission or, perhaps, considered abstention from regulation. In that event, judges are not accredited to supersede Congress or the appropriate agency by embellishing upon the regulatory scheme. Accordingly, caution must temper judicial creativity in the face of legislative or regulatory silence.

"At the very least, that caution requires attentiveness to the views of the administrative entity appointed to apply and enforce a statute. And deference is especially appropriate in the process of interpreting the Truth in Lending Act and Regulation Z. Unless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive for several reasons.

". . . [T]raditional acquiescense in administrative expertise is particularly apt under TILA, because the Federal Reserve Board has played a pivotal role in 'setting [the statutory] machinery in motion. . . .' [Citation omitted.] . . . Congress delegated broad administrative lawmaking power to the Federal Reserve Board when it framed TILA. The Act is best construed by those who gave it substance in promulgating regulations thereunder. . . . Moreover, language in the legislative history evinces a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation. . . . Courts should honor that congressional choice. Thus, while not abdicating their ultimate judicial responsibility to determine the law, . . . judges ought to refrain from substituting their own interstitial lawmaking for that of the Federal Reserve, so long as the latter's lawmaking is not irrational.

"Finally, wholly apart from jurisprudential considerations or congressional intent, deference to the Federal Reserve is compelled by necessity; a court that tries to chart a true course to the Act's purpose embarks upon a voyage without a compass when it disregards the agency's views." (444 U.S. at pp. 565-568.0

psychology and that presupposes broad experience with credit practices. Administrative agencies are simply better suited than courts to engage in such a process." (444 U.S. at pp. 568-569.)

The Board's determination that if the meaning of the term "Rule of 78's" were defined in conditional sale contracts the result would confuse consumers and detract from other important disclosures is an attempt by the Board to strike the balance between "competing considerations of complete disclosure . . . and the need to avoid . . . ['informational overload]' "[9] and state law which would require explanation of the rule would disturb that balance.[10]

Our conclusion is further buttressed by an unofficial letter interpretation of Regulation Z by the Board, issued at defendant's request after the commencement of this litigation. The letter states that in light of the Board's conclusion that the operation of the "Rule of 78's" cannot be explained in a simple manner and that an attempt at an explanation would detract from other important disclosures required by the regulation, "it is the staff's opinion that a state law (whether statutory or judicially imposed) requiring disclosure of the meaning and implication of the Rule of 78's formula would be inconsistent with Regulation Z. . . ."

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[9]Congress appears to be heading in the direction of fewer, more simplified disclosures. After a nationwide consumer credit survey revealed that disclosure statements were too complicated, Congress recently amended the TILA to provide that as of 1982, a lender need only indicate whether or not the consumer is entitled to a rebate of any finance charge upon prepayment. (Pub.L.No. 96-221, §§ 614, subd. (a), 625, subd. (a); 94 Stat. 132 (Mar. 31, 1980).)

[10]A recent report of the Senate Banking, Housing and Urban Affairs Committee recommends that state legislatures prohibit the utilization of the "Rule of 78's" for long term transactions. The committee also recommends the establishment of a National Consumer Usury Commission to consider whether Congress should prohibit use of the rule. (Sen. Rep. No. 96-923, 2nd Sess., p. 11 (1980).)

Plaintiff argues that Regulation Z permits disclosures pursuant to state requirements in addition to and inconsistent with those set forth in the regulation, provided that the form of such disclosures comports with the provisions of section 226.6, subdivision (c) of Regulation Z. Subdivision (c) states that a creditor may, at his option, provide additional information or explanations to a consumer if the additional matter does not mislead the customer or obscure or detract from the disclosures required by Regulation Z, and provided also that these additional disclosures are made on a separate paper or are clearly identified as state disclosures and appear below the disclosures required by the regulation.

Plaintiff's assertion is without merit for two reasons. First, both the regulation and the unofficial board interpretation referred to make it clear that a creditor may *elect* to make explanations provided for by state law which are inconsistent with Regulation Z, but may not be required to do so.[11] Second, the Board has determined that explanation of the rule would mislead the customer and detract from other important information which Regulation Z requires to be disclosed in the contract; therefore, an explanation of the rule is prohibited by the terms of subdivision (c) even if the creditor complies with the format specified therein.[12]

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[11]The letter from the Board states, "It is the staff's opinion that the making of inconsistent state disclosures in accordance with § 226.6(c) is done at the creditor's option; a creditor could elect not to make the state-required disclosures."

[12]Mason v. General Finance Corp. of Virginia (1976) 542 F.2d 1226, relied upon by plaintiff, is distinguishable. It was there held that a state disclosure law which required the use of terminology different than specified by TILA was inconsistent with the federal enactment, but that the state-imposed terminology could appear in the contract provided that it was not intermingled with the information required by Regulation Z and complied with the requirements of form set forth in subdivision (c) of section 226.6. Unlike the present case, *Mason* did not involve the question whether an inconsistent state disclosure requirement was mandatory upon the creditor since the issue there was not the creditor's failure to disclose but an improper form of disclosure. Second, *Mason* did not deal with the creditor's failure to explain a term in the contract which the consumer did not comprehend and a determination by the Board that an explanation would confuse the consumer.

Plaintiff next asserts that a requirement imposed by the state that a conditional sale contract warn the consumer of the consequences of the application of the rule would not violate federal law and would alert consumers to the disadvantages inherent in the operation of the rule.

It is probably ture that a statement in the nature of a warning to the consumer is not contrary to federal law. (See 12 C.F.R. § 226.604, subd. (b).)[13] However, we cannot conclude that a court may impose a requirement for such a warning under the law of adhesion contracts. The warning would not resolve any ambiguity in the meaning of the term "Rule of 78's" and thus would not cure the only contract defect upon which plaintiff relies.[14]

We conclude, therefore, that the trial court did not err in sustaining the demurrer. Nevertheless, since both parties have discussed at great length whether the rule is fair to consumers and whether its use is justified because of the manifest benefits to the creditor, we discuss their assertions in this regard.

Although a simple explanation of the operation of the "Rule of 78's," if one could be devised, or a warning of

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[13]The section provides: "Whether State laws are inconsistent with Regulation Z necessarily depends on the nature of the State laws. Section 226.6(b)(1) provides that State law is inconsistent to the extent that it 'requires a creditor to make disclosures different from the requirements of this part with respect to form, content, terminology, or time of delivery.' This refers to disclosures of the kinds of information covered by Regulation Z, and not to other or collateral information such as a statement telling the customer that he should read the contract carefully, or that there should be no blanks in the contract. . . ."

[14]An additional principle of the law of adhesion contracts is that even a term clearly stated may be unenforceable if it is so unconscionable that its enforcement would be contrary to public policy. (See, e.g., Tunkl v. Regents of University of California (1963) 60 Cal.2d 92, 99-101.) But, although plaintiff asserts that the rule is unfair to consumers, an argument which we shall discuss in detail, *infra*, he does not seek its invalidation for that reason; his complaint focuses upon the absence of an explanation of the operation of the rule.

its disadvantages, could be of some assistance to consumers,[15] the more fundamental question is whether utilization of the rule should be permitted at all.

In considering fairness to the consumer, we begin with the observation that the rule applies not only to a borrower who repays a loan in full prior to maturity and liquidates the debt, but also to prepayment because of refinancing or consolidation of debts. In the latter event, the rule is applied to the renewed debt as part of the amount financed. A very substantial number of loans are refinanced or consolidated, perhaps as high as 70% or 80% in some types of loans.[16] According to defendant, 43 states authorize calculation of a prepayment rebate by the "Rule of 78's" but most of them limit the term or size of the loan to which the rule may be applied.[17] One popular writer on financial affairs declares that the Federal Trade Commission estimates the exaction of the finance charge under the rule costs the consumer $112 million a year in "overcharges" although some estimates place the figure more conservatively at between $50 million and $100 million a year. (Porter, *Your Money, Learning About the "Rule of 78's"* San Francisco Chronical (April 18, 1980) p. 34, col. 1.) Thus, it is clear that the rule is applied to a vast number of consumer transactions

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[15]There is some question whether even a simplified explanation would be meaningful to a consumer without a reference to the actuarial method of computation and an explanation of its advantages over the "Rule of 78's" so that the consumer would have some means of comparison. There is considerable doubt whether the complexity of such an explanation would not outweigh its benefits, even if a state were free to require an explanation.

[16]Hunt, *Hidden Penalty in the Rule of 78*, (1975) 55 Boston L.Rev. 331, 333 (hereafter *Hunt*).

[17]As we shall see, recent amendments to the Rees-Levering Act and the Unruh Act have limited the term of a loan to which the rule may be applied.

and that the cost to the consumer from its utilization is enormous.

Defendant, in support of its argument that the calculation of a rebate by the "Rule of 78's" does not yield significantly different results from the actuarial method, employs a small loan ($1,200) of short duration (one year) to demonstrate that the difference between the two methods amounts to only 71 cents if the loan is repaid in the fourth month. (See fn. 3, *ante* at p. 5.) However, if the amount of the loan or its term is increased, use of the rule can result in a much smaller refund than if the actuarial method were applied. *Hunt*, in a revealing exposition of the manner in which the rule operates, offers the following examples: a $15,000 mobile home financed over a period of 12 years at the rate of $9 per $100 in interest, and repaid at the end of the 52nd month, requires the lender to rebate $1,157 more if the amount of the rebate is calculated by the actuarial method than by the "Rule of 78's." Using the loan terms, a borrower who prepays the loan in the first three months of its term will pay over 17 percent interest expressed as the annual percentage rate [the only figure in the contract which discloses to the borrower how much credit costs him (Mason v. General Finance Corp., supra, 542 F.2d 1226, 1233)] which is more than three percent over the rate actually disclosed in the contract. Even for a loan of a shorter term (48 months) and a far lesser amount ($5,000), the buyer receives $54 less as a rebate under the rule than if the actuarial method were utilized. (*Hunt, op cit. supra*, at pp. 347, 361.)

Other commentators have remarked upon the unfair effect of the rule on consumers. (See, e.g., Comment, *Consumer Protection: Truth-in-Lending Disclosure of the Rule of 78ths*, 59 Iowa L.Rev. 164, 175-176; *Legislative Regulation*

of Retail Installment Financing, 7 U.C.L.A. L.Rev. 618, 685-686.)

Defendant insists that the rule is fair to borrowers and its use justified by the business needs of the creditor. First, it asserts, it is easier to calculate a rebate by the rule than by the actuarial method. Whatever may have been true in the late 19th and early 20th centuries, when businessmen were required to calculate rebates manually, the advent of computers has eliminated this basis as support for use of the rule; undoubtedly, in the very large majority of credit transactions today the lender has a mechanical device available to readily determine the rebate. Even for the relatively few creditors who do not have access to such a machine, the use of pre-calculated, published tables of refunds payable under the actuarial method would substantially resolve the problem. (See, *Hunt, op cit. supra*, at p. 360.)

The second justification advanced by defendant is that the rule permits creditors to recover their transaction costs, and unless such costs are recovered, the borrower who does not prepay his loan in effect subsidizes the borrower who does. These transaction costs include those associated with extending credit in the first instance, such as the expense of advertising, depreciation, insurance, and other overhead expenses, the cost of carrying the credit after it has been extended, the expenses incurred in connection with bad debts, and collection and litigation expenses for delinquent loans. Defendant urges that these charges are spread over the term of the obligation upon the assumption that all payments will be made over the originally agreed-upon term of the contract, and that if the obligation is prepaid, the creditor does not recover them fully.

This problem may be resolved by requiring the borrower to pay a minimum finance charge for each transaction to reimburse the creditor for such costs. Furthermore, the

charge to the debtor by application of the rule bears no relationship to the costs involved in the processing and collection of his particular loan. Thus, a borrower who has faithfully made installment payments on time and who prepays the loan early in the term in fact decreases the transaction costs to a lender attributable to his loan, but he is in effect penalized by being compelled to pay a charge to assure that the lender recoups its investment from debtors who are less conscientious. In these respects, the borrower who pays his debt early may, in effect, subsidize those who do not pay at all. (Cf. Bondanza v. Peninsula Hospital & Medical Center (1979) 23 Cal.3d 260, 268-269; Garrett v. Coast & Southern Fed. Sav. & Loan Assn. (1973) 9 Cal.3d 731, 741.)[18]

Defendant asserts in addition that the use of the rule assures the creditor that he will receive the benefit of his bargain. Prepayment results in placing the creditor at the "risk of the market" in that he may not be able to obtain the same rate of return on new extensions of credit if interest rates are declining or the demand for credit is decreased, and he is put to the expense of seeking new investment opportunities and will incur additional transaction costs for such new investments. As to these last two items, they are included within the transaction costs referred to above. In the last few years the dramatic increase in the interest rate renders it unlikely that the creditor will suffer a loss from prepayment and reinvestment. The presumption that such a loss will occur and the automatic penalization of the borrower based upon such an assumption appears unsupportable.

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[18]In *Bondanza*, we held in view of the provisions of section 1671, subdivision (d), of the Civil Code that it was unlawful to impose upon a debtor a collection charge which bore no relationship to the actual cost of collection.

Another important factor in considering the validity of defendant's arguments is that neither the necessity for the creditor to recoup transaction costs nor to afford him the benefit of his bargain can justify application of the "Rule of 78's" to the vast number of loans made to refinance or consolidate debts. In the case of such loans, the unamortized transaction costs are carried over into the new debt, and the creditor is obviously not put at the "risk of the market" since the new loan is extended at the same time the old loan is prepaid,. The manifest absence of any justification for applying the rule to such transactions has led *Hunt* to suggest that is the rule is retained at all it should only be applied to the complete retirement of a debt on prepayment. (*Hunt, op cit. supra*, at p. 358.)

Finally, defendant urges that the use of the rule to compute rebates is not unfair to the consumer because it yields results comparable to the actuarial method as utilized to compute the interest charge on mortgages of real property. Defendant's assertion is based on the traditional real estate financing transaction, in which the lender may charge a prepayment penalty (Civ. Code, §2954.9) as well as a loan origination fee. When the penalty and the fee are added together, they may yield to the lender an amount comparable to the sum he would receive by application of the rule. We suggest this reasoning illustrates the shortcomings of the "Rule of 78's." Defendant admits that prepayment penalties are prohibited by statute for determining rebates under retail installment contracts. (Civ. Code, §2982, subd. (e)(1).) While we recognize that the Board has determined that calculation of the rebate by the rule does not amount to a "prepayment penalty," as defined in Regulation Z (12 C.F.R., §226.818, subd. (b)), nevertheless the smaller refund to the consumer and the concommitant greater profit to the lender under the rule serves, in defendant's own words

"as an alternate means by which . . . [it] can recoup the losses caused by prepayment of the contract." Thus, while application of the rule technically or semantically may not be termed a "penalty" in view of the Board's interpretation, it serves as a substitute for the prepayment penalty prohibited by statute.

In sum, the "Rule of 78's" is a hidden charge the operation of which is neither revealed to nor understood by the borrower, and it is a charge burdensome to the consumer and unjustified by the economic needs of the lender. Its adoption as the prevailing rule in this state is, of course, a legislative decision involving the weighing of policy matters as seen by legislators. Thus we would not be free to substitute our own views for those of the Legislature regarding the desirability of the rule even if plaintiff had sought a determination that it is invalid as a measure of the rebate because it is unfair to the consumer. The common law, which petitioner urges us to apply, is superseded when the Legislature acts. (People v. Hickman (1928) 204 Cal. 470, 479; Lowman v. Stafford (1964) 226 Cal.App.2d 31, 39.)

The Legislature has considered the rebate due a buyer on prepayment, the "Rule of 78's," and the manner of its disclosure a number of times in recent years. (Rees-Levering Act: Stats. 1961, ch. 1626, §4, pp. 3534, 3537; Stats. 1970, ch. 1003, §1, pp. 1800, 1803; Unruh Act: Stats. 1969, ch. 625, pp. 1264, 1266; Stats 1970, ch. 546, §14, pp. 1040, 1043-1044; Stats. 1971, ch. 1061, §1, pp. 2022, 2023.)[19] In 1979, it enacted several measures to alleviate the harsh-

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[19]The 1969 amendment to the Unruh Act required the lender to "explain" the method for computing the rebate on prepayment. However, this requirement was repealed the following year, when the statute was amended to provide that a reference to the rule was sufficient identification of the method of computing the rebate.

ness of the rule in certain transactions. Beginning in 1983, Rees-Levering contracts calling for payment in more than 62 months may not utilize the rule to calculate the amount of rebate due a buyer on prepayment. (Stats. 1979, ch. 805, §19, p. 2880.) As of January 1, 1981, the contract must include the following statement: "Because the refund [on prepayment] will be figured by the rule of 78's, the time when you prepay may affect the ultimate cost of credit under this agreement." (Civ. Code, §2982, subd. (a)(14)(A).)[20] Thus it is clear that the Legislature is aware of the issue surrounding the "Rule of 78's" and has taken such action as it deems appropriate. We would abuse judicial authority if we were to embellish legislative requirements.

The judgment should be affirmed.

MOSK, *J.*

WE CONCUR:

BIRD, *C.J.*
TOBRINER, *J.*
CLARK, *J.*
RICHARDSON, *J.*
NEWMAN, *J.*

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[20]Similar restrictions are imposed with regard to installment sale contracts which come under the Unruh Act. (Civ. Code, §1799.8, subd. (b); 1803.2, subd. (c).)

State of California, County of Kern, ss.

I, David Griffin, depose and say that I am an attorney in the office of Young, Wooldridge, Paulden, Self, Farr & Hugie, attorney of record for Loyd Drennan, the Petitioner herein, and that on April 8, 1981, pursuant to Rule 33, Rules of the Supreme Court, I served the attached application for extension of time on each of the parties required to be served herein, as follows:

Mr. William M. Burke,
SHEPPARD, MULLIN, RICHTER & HAMPTON
Attorneys at Law
4000 MacArthur Boulevard, Suite 500
Newport Beach, CA. 92660

All parties required to be served have been served.

/s/ David Griffin
DAVID GRIFFIN

Subscribed and sworn to before
me on April 8, 1981.

/s/ Susan Tull
NOTARY PUBLIC

[Notarized]

APPENDIX B.

"(7) Identification of the *method of computing any unearned portion of the finance charge* in the event of prepayment in full of an obligation which includes precomputed finance charges and a statement of the amount or method of computation of any charge that may be deducted from the amount of any rebate of such unearned finance charge that will be credited to an obligation or refunded to the customer. If the credit contract does not provide for any rebate of unearned finance charges upon prepayment in full, this fact shall be disclosed."

12 C.F.R. §226.8(b)(7)

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No. 80-2118

IN THE

Supreme Court of the United States

October Term, 1980

LOYD S. DRENNAN,

Petitioner,

vs.

SECURITY PACIFIC NATIONAL BANK,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of California.

RESPONDENT'S BRIEF IN OPPOSITION.

SHEPPARD, MULLIN, RICHTER & HAMPTON,
A Partnership including
Professional Corporations,
GEORGE R. RICHTER, JR.,
WILLIAM M. BURKE,
JEFFREY S. TURNER,
333 South Hope Street, 48th Floor,
Los Angeles, Calif. 90071,
(213) 620-1780,
Attorneys for Respondent.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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No. 80-2118

IN THE

Supreme Court of the United States

October Term, 1980

LOYD S. DRENNAN,

Petitioner,

vs.

SECURITY PACIFIC NATIONAL BANK,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of California.

RESPONDENT'S BRIEF IN OPPOSITION.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Respondent, Security Pacific National Bank, respectfully requests that this Court deny the Petition for Writ of Certiorari seeking review of the Supreme Court of California's unanimous opinion in this case, reported at 28 Cal. 3d 764 (1981).

Introductory Statement.

Although Petitioner's Statement of the Case is basically accurate, certain additional points should be emphasized:

1. Petitioner's mobile home conditional sale contract was subject to California's Rees-Levering Motor Vehicle

Sales and Finance Act ("The Rees-Levering Act"), Cal. Civ. Code §§ 2981-2984.4 (West).

2. The Rees-Levering Act comprehensively regulates both the substantive and disclosure requirements pertaining to motor vehicle conditional sale contracts, and is regularly revised and amended by the California Legislature.

3. Among other things, the Rees-Levering Act requires the creditor to provide the consumer with a rebate of unearned finance charge upon prepayment. The Act expressly authorizes the creditor to compute the rebate according to the Rule of 78's. Rees-Levering Act § 2982(e).

4. The Act does not require the creditor to disclose in detail the meaning or implications of use of the Rule of 78's. Rather, the Act provides that disclosures may be made as required or permitted by Regulation Z.[1] Rees-Levering Act § 2982(g).

5. Petitioner concedes that his contract complied fully with the Act. Petition for Writ of Certiorari, pp. 4-5. Petitioner does not challenge the validity of the Act.

6. Petitioner's contract was also subject to the Truth in Lending Act[2] and Regulation Z, which require only that the method of rebate be identified by name.[3]

7. Petitioner concedes that his contract complied fully with the Truth in Lending Act and Regulation Z. Petition for Writ of Certiorari, pp. 4-5. Petitioner does not challenge the validity of the Truth in Lending Act or Regulation Z.

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[1]12 C.F.R. § 226 (1980). Unless otherwise noted, all references herein to Regulation Z are to "old" Regulation Z, which was in effect when this case was litigated in the California courts. As discussed in Part I(D) of this Brief, Regulation Z was totally revised and reissued on March 26, 1981 to conform to the provisions of the Truth in Lending Simplification and Reform Act. Revised Regulation Z has prospective application only and is not relevant to this case.

[2]15 U.S.C. §§ 1601-1677 (1976).

[3]See Parts I (A)-(C) of this Brief.

8. Petitioner's sole contention throughout this case has been that the prepayment rebate clause in his contract somehow violates California common law contract of adhesion principles. Petition for Writ of Certiorari, p. 5. However, his litigation posture both as to the nature of the violation alleged and the remedy sought has apparently undergone substantial change since his Complaint was filed.

9. In his Complaint, Petitioner alleged only that the prepayment rebate clause of his contract was "vague, ambiguous and uncertain" and thus "void, and unenforceable."

10. In the Superior Court and the Court of Appeal, Petitioner took the position that Respondent should have provided him with a detailed explanation of the meaning and implications of the Rule of 78's. He never specified what the remedy should be for Respondent's alleged failure to do so (merely holding the rebate clause unenforceable would have accomplished nothing since the Rees-Levering Act would have provided an identical rebate under section 2982(e)).

11. In the California Supreme Court, Petitioner fundamentally changed his litigation posture by conceding that a detailed explanation of the meaning and implications of the Rule of 78's probably would confuse consumers and be of doubtful benefit.[4] Petitioner instead urged the California Supreme Court to require a "simple warning" as to the Rule's effects.[5]

12. Respondent's decision not to include a detailed explanation of the meaning and implications of the Rule of 78's in its contract form was not premised, as Petitioner erroneously contends, on a desire "to prevent meaningful

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[4]Appellant's Response Brief in the California Supreme Court, p. 17.
[5]Appellant's Response Brief in the California Supreme Court, pp. 15-17. The California Supreme Court refused to require such a warning on the ground it is not required by contract of adhesion principles. See Part II (B) of this Brief.

disclosure of credit terms and to mandate the uninformed use of credit."[6] Rather, it was based on a desire to comply with the detailed and explicit requirements of the Rees-Levering Act, the Truth in Lending Act and Regulation Z.

REASONS WHY THE WRIT SHOULD BE DENIED.

I.

THE PETITION HEREIN RAISES NO SUBSTANTIAL FEDERAL QUESTION.

For Petitioner to properly invoke the jurisdiction of this Court, it is essential that he raise a substantial federal question. If Petitioner's contentions are devoid of merit, or foreclosed by prior decisions of this Court so as to leave no room for real controversy, this Court should not hear the case. *Equitable Life Assurance Soc. v. Brown*, 187 U.S. 308, 311 (1902); *Zucht v. King*, 260 U.S. 174 (1922).

Petitioner has not and cannot satisfy this requirement because, as shown below, his contentions are devoid of merit and expressly foreclosed by a recent decision of this Court.[7]

A. The California Supreme Court Correctly Refused to Require Additional Disclosures Contrary to Federal Law.

To insure that the Truth in Lending Act would not be frustrated by inconsistent state disclosure laws, Congress expressly provided in section 111(a) thereof that state laws requiring disclosure of information in connection with credit transactions are not binding upon a creditor to the extent that they are inconsistent with the provisions of the Act or Regulation Z. 15 U.S.C. § 1610(a) (1976). State laws that provide for inconsistent disclosures of credit information

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[6]Petition for Writ of Certiorari, p. 5.

[7]The federal preemption issue is discussed in this section of the Brief. Petitioner's "federal administrative procedure" and "due process" claims are discussed in Part III.

are preempted regardless of whether they are statutory or judicial in origin or whether they are imposed as a rule of disclosure or as a rule of substantive contract law. *See Mason v. General Finance Corp.*, 542 F.2d 1226, 1234 (4th Cir. 1976).

Section 226.6(b)(1)(i) of Regulation Z defines as "inconsistent" any state law that "[r]equires a creditor to make disclosures or take actions different from the requirements of this part with respect to form, content, terminology, or time of delivery."

Besides preempting inconsistent state law disclosure requirements, Regulation Z also prohibits creditors from disclosing information in addition to Regulation Z required disclosures if the additional information would "mislead or confuse the consumer . . . or contradict, obscure or detract attention from the information required . . . to be disclosed." 12 C.F.R. § 226.6(c) (1980).

The California Supreme Court correctly concluded that to require a creditor to explain in detail the meaning and implications of the Rule of 78's rebate formula both would be (1) inconsistent with Regulation Z as interpreted by the Federal Reserve Board ("the Board"),[8] because it would require the creditor "to make disclosures or take actions different from the requirements of [Regulation Z] with respect to form, content [and] terminology . . .," and (2) prohibited by section 226.6(c) even if not inconsistent since it would "mislead or confuse the consumer . . . [and]

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[8]The Board's interpretations of Regulation Z requirements relating to use and disclosure of the Rule of 78's are discussed in Part I (B) of this Brief.

contradict, obscure or detract attention from the information required . . . to be disclosed."[9]

B. The Federal Reserve Board and the Courts Have Consistently and Repeatedly Ruled That Additional Disclosures Such as Those Sought by Petitioner Are Not Required by Regulation Z and Would Confuse Consumers and Detract From Other Required Disclosures.

In his Petition for Writ of Certiorari, Petitioner seeks to convey the erroneous impression that the California Supreme Court decided this case based solely on the text of Section 111 of the Truth in Lending Act (15 U.S.C. § 1610 (1976)), Regulation Z § 226.6(b) and one unofficial staff interpretation letter. Petitioner asserts that the California Supreme Court's ruling was "essentially a matter of first impression since no official Federal Reserve Board interpretation or court ruling had issued on the subject."[10]

This assertion is false. The central question in this case has been the subject of numerous Federal Reserve Board Official Board Interpretations, Official Staff Interpretations, Public Information Letters and cases which establish beyond

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[9]In *Mason v. General Finance Corp.*, 542 F.2d 1226 (4th Cir. 1976), the court struck down a state law requiring disclosures in addition to those required by Regulation Z. In response to contentions that the state disclosures simply explained and augmented the federal disclosures, the court stated that the additional disclosures "told the borrower more than he need[ed] to know and more than he [could] possibly understand." *Id.* at 1233. In language that could have been written for this case, the court stated:

> "We hold that the Congress may rationally adopt a national loan terminology for the purpose of enabling the comparison of the cost of credit and may require the subordination of state terminology *even though it is true and accurate*." 542 F.2d at 1233 (emphasis added).
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> . . .
>
> "It is precisely because such true information can be worse than meaningless that the Congress determined upon uniformity of terminology." *Id.*

[10]Petition for Writ of Certiorari, p. 8.

any doubt that a state may not, either by statute or application of common law principles, require additional disclosures of the type sought by Petitioner.[11]

The history of Board actions concerning disclosure of the Rule of 78's reflects a balancing of competing policy considerations. Balanced against the desire to provide consumers with an explanation of the meaning and implications of the Rule of 78's, was the need to keep disclosures simple, uniform and meaningful so that consumers would be encouraged to read disclosure forms and comparison shop for credit. After carefully weighing the competing policy considerations, the Board justifiably concluded that detailed disclosures regarding the Rule of 78's would unduly lengthen and complicate disclosure forms and would be of doubtful utility to consumers. The Board thus opted for limited disclosure of the Rule of 78's under Section 226.8(b)(7) of Regulation Z, and on April 30, 1973, issued an Official Board Interpretation concluding that a creditor need only identify the rebate method employed upon prepayment and need not explain the method. 12 C.F.R. § 226.818 (1980).

The Board's concern that an explanation of the Rule of 78's would confuse consumers and detract from other important disclosures was subsequently expressed in numerous staff letters issued in support of the Board interpretation. Brief excerpts from those letters follow:

> "After reviewing various methods of describing the working of the Rule of 78's, we are convinced that even the most simplified definition of the Rule in a disclosure statement would work to the disadvantage

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[11] A chronology of the actions of the Federal Reserve Board regarding disclosure of the Rule of 78's is appended to this Brief as Appendix "A."

The California Supreme Court was fully briefed on these numerous Board pronouncements and considered them in rendering its opinion below.

of consumers by distracting their attention from the more important annual percentage rate and finance charge disclosures."[12]

. . .

"[W]hile it is certainly desirable for consumers to be better informed about rebate methods, the Board does not believe that this can be accomplished by the Truth in Lending disclosure statement without detriment to the broader goal of increasing consumer awareness of finance charges and interest rates. . . . It is certain that [additional] language would further complicate disclosures which many claim are already more complicated than desirable to insure consumer understanding."[13]

. . .

"As indicated in § 226.818, Regulation Z does not require disclosure of the complex mathematical descriptions of rebate methods since such could only serve to detract from other important Truth in Lending disclosures. Rather, § 226.818 provides that the requirement of 'rebate identification' is satisfied simply by referring by name to the 'Rule of 78's' or other method, as applicable.

It is staff's opinion that, in order to provide a concise and effective disclosure statement, § 226.8(b)(7) does not require the disclosure of the complex details necessary to allow the consumer to calculate the amount of every possible rebate, regardless of when prepayment in full may occur. Section 226.8(b)(7) simply aims to provide the customer with some basic information; such as, whether or not the customer receives a rebate of the precomputed but unearned finance

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[12]Federal Reserve Board Letter of May 24, 1973, Cons. Cred. Guide (CCH) ¶ 31,016 (1969-1974 Tr. Binder).

[13]Federal Reserve Board Letter of June 6, 1973, Cons. Cred. Guide (CCH) ¶ 30,983 (1969-1974 Tr. Binder).

charges, and the identification of the method whereby any rebate provided is calculated."[14]

. . .

"[I]t is the staff's opinion that a state law (whether statutory or judicially imposed) requiring disclosure of the meaning and implication of the Rule of 78's formula would be inconsistent with Regulation Z, under § 226.6(b)(1). This opinion is based on the fact that the content of such a disclosure would be different from what is required by §§ 226.8(b)(7) and 226.818, and could detract from the other required disclosures.[15]

The Official Board Interpretation has also received widespread judicial support. *See, e.g., Bone v. Hibernia Bank,* 493 F.2d 135, 139 (9th Cir. 1974); *Gantt v. Commonwealth Loan Co.,* 573 F.2d 520 (8th Cir. 1978); *Grant v. Imperial Motors,* 539 F.2d 506, 509 (5th Cir. 1976); *Gillard v. Aetna Finance Co.,* 414 F. Supp. 737, 746 (E.D. La. 1976); *Roberts v. National School of Radio & Television Broadcasting,* 374 F. Supp. 1266, 1269 (N.D. Ga. 1974), *overruled on other grounds, Mims v. Dixie Finance Corp.,* 426 F. Supp. 627 (N.D. Ga. 1976).

The foregoing authorities show that the additional disclosures sought by Petitioner are not only not required by Regulation Z, but are prohibited by Regulation Z because they are (1) clearly inconsistent with Regulation Z as interpreted by the Board, and (2) would confuse consumers and detract attention from other required disclosures.

C. The California Supreme Court Correctly Applied This Court's Decision in Ford Motor Credit Co. v. Milhollin.

In deferring to the Board's interpretations of Regulation Z, the California Supreme Court correctly applied this

[14]Federal Reserve Board Public Information Letter No. 1168, March 22, 1977, Cons. Cred. Guide (CCH) ¶ 31, 561 (1974-1977 Tr. Binder).

[15]Federal Reserve Board Letter of September 24, 1980 (A copy of this letter was made a part of the record in the California Supreme Court).

Court's recent decision in *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555 (1980). *Milhollin* involved a claim remarkably similar to the claim made by Petitioner in this case. There, plaintiff claimed that the creditor failed to adequately disclose its method of rebating unearned finance charges upon acceleration. The Board had issued an Official Staff Interpretation and three staff letters which supported the method of disclosure employed by the creditor. Nevertheless, the United States Court of Appeals for the Ninth Circuit rejected the Board's interpretations and held that the creditor should have made different disclosures. *Milhollin v. Ford Motor Credit Co.*, 588 F.2d 753 (9th Cir. 1978), *reversed*, 444 U.S. 555 (1980).

In a unanimous opinion, this Court reversed the Ninth Circuit, and cautioned against judicial creativity in the context of consumer credit disclosure legislation where the absence of additional disclosure requirements may signal a legislative decision not to require disclosure:

> "It is a commonplace that courts will further legislative goals by filling the interstitial silences within a statute or regulation. Because legislators cannot foresee all eventualities, judges must decide unanticipated cases by extrapolating from related statutes or administrative provisions. But legislative silence is not always the result of a lack of prescience; it may instead betoken permission or, perhaps, considered abstention from regulation. In that event, judges are not accredited to supersede Congress or the appropriate agency by embellishing upon the regulatory scheme. Accordingly, caution must temper judicial creativity in the face of legislative or regulatory silence." 444 U.S. at 565.

This Court held that the creditor was not required to make the additional disclosures demanded by plaintiff, relying on the Board's staff interpretations, which were held to be

binding upon courts unless they are "demonstrably irrational." 444 U.S. at 565. In articulating this strict standard of deference, this Court acknowledged and approved the Board's quest for simplicity and meaningfulness in credit disclosures:

> "The concept of 'meaningful disclosure' that animates TILA, . . . cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . [informational overload.]' " 444 U.S. at 568 (citations omitted).[16]

Milhollin enunciated two important principles which apply to this case. First, that the Truth in Lending Act was intended to provide consumers with simple, meaningful credit cost disclosures designed to encourage comparison shopping for credit; and that the goals of the Truth in Lending Act should not be frustrated by the imposition of additional disclosure requirements which detract from the basic required disclosures. Second, that the Board has the primary responsibility and expertise to interpret the Truth in Lending Act and Regulation Z, and courts should defer to its interpretations unless they are "demonstrably irrational."

The California Supreme Court correctly applied both of these principles when it refused to impose the additional disclosure requirements sought by Petitioner.

D. 12 C.F.R. § 226.28(a) Is Inapplicable to This Case.

For the first time in this Court, Petitioner relies on 12 C.F.R. § 226.28(a) (1981) to argue that the additional dis-

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[16]The philosophy that meaningful disclosure does not mean more disclosure was reiterated by this Court in two recent decisions. *Anderson Bros. Ford v. Valencia*, ... U.S. ..., ..., 49 U.S.L.W. 4635, 4639-40 (June 8, 1981); *Ford Motor Credit Co. v. Cenance*, ... U.S. ..., ..., 49 U.S.L.W. 3892, 3893 (June 1, 1981) (per curiam).

closures he seeks are not preempted by federal law because they do not "contradict" federal disclosure requirements. What Petitioner fails to point out is that section 226.28(a) is not applicable to this case.

Section 226.28(a) was issued by the Board on March 26, 1981, as part of a complete revision of Regulation Z designed to implement sweeping changes in Truth in Lending requirements enacted by the Truth in Lending Simplification and Reform Act (including revised provisions dealing with inconsistent state disclosures). The Act (Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub.L.No. 96-221, 94 Stat. 132 (1980)) does not take effect until April 1, 1982. Revised Regulation Z became effective April 1, 1981, but creditors may opt to continue to comply with old Regulation Z until April 1, 1982. Because the Act and revised Regulation Z only apply prospectively, section 226.28(a) is not applicable to this case.

Petitioner's contract was executed and disclosures were made to Petitioner based on the Truth in Lending Act and the Regulation Z in effect in 1974. Petitioner commenced this lawsuit in 1977. Every issue in this case, from the Superior Court to the California Supreme Court, was decided under the old Truth in Lending Act and the old Regulation Z. The Truth in Lending Simplification and Reform Act and Revised Regulation Z § 226.28(a) plainly have no application to this case.[17]

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[17]Even if section 226.28(a) was applicable to this case, the California Supreme Court would still have been compelled to conclude that the disclosures sought by Petitioner "contradict" the disclosure policies consistently enunciated by the Board.

E. There Is No Conflict in the Decisional Law Which Would Justify Review by This Court, and There Is No Basis for Review Under Supreme Court Rule 17.1.

This Court has consistently emphasized that review by writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons, as where there is a conflict in the decisional law of the lower courts, or where a decision is rendered in conflict with opinions of this Court, or where important questions of federal law have not been, but should be, decided by this Court.[18]

None of those considerations apply in the present case. As shown in the preceding sections of this Brief, this case presents no substantial questions of federal law which call for resolution by this Court. On the contrary, the central issue in this case, deference by the California Supreme Court to Board interpretations prohibiting the disclosures sought by Petitioner, was resolved by this Court's recent decision in *Milhollin*.

Nor is the opinion below in conflict with any decisions of the Federal Courts of Appeals.[19] Nor does Petitioner assert any conflict with a decision of the high court of any other state. In fact, Petitioner has not cited, and Respondent is not aware of, any decisions in conflict with the opinion below. The Petition thus fails to satisfy any of the criteria

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[18]*See generally Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 392-93 (1923); *Keller v. Adams-Campbell Co.*, 264 U.S. 314 (1924); *Avco Corp. v. Aero Lodge No. 735*, 390 U.S. 557, 559, *rehearing denied*, 391 U.S. 929 (1968); *Henderson v. Kibbe*, 431 U.S. 145, 152 (1977); *Lego v. Twomey*, 404 U.S. 477, 479 n.1 (1972). The considerations governing review on certiorari are summarized in Supreme Court Rule 17.1.

[19]All applicable circuit decisions, *e.g.*, *Bone v. Hibernia Bank*, 493 F.2d 135 (9th Cir. 1974) and *Mason v. General Finance Corp.*, 542 F.2d 1226 (4th Cir. 1976), are entirely consistent with the opinion below.

set forth in the case law and in this Court's Rule 17.1 which would justify review on writ of certiorari.

II.

THE OPINION OF THE CALIFORNIA SUPREME COURT RESTS ON ADEQUATE AND INDEPENDENT STATE GROUNDS.

This Court has consistently adhered to the principle that it will not review a state court judgment which rests upon adequate and independent state grounds, regardless of whether a federal question is involved. *Murdock v. Mayor of Memphis*, 87 U.S. (20 Wall.) 590, 636 (1875); *Berea College v. Kentucky*, 211 U.S. 45, 53 (1908); *Fox Film Corp. v. Muller*, 296 U.S. 207 (1935).

In the present case, although its decision was based primarily on federal preemption, the California Supreme Court enunciated two distinct, adequate and independent state grounds for its decision which are not reviewable by this Court.

A. The California Supreme Court Correctly Held That California Common Law Contract of Adhesion Principles Do Not Apply to Disclosure of the Rule of 78's Because Such Principles Were Superseded by Extensive California Legislation.

Petitioner concedes that his conditional sale contract was subject to the Rees-Levering Act, and that the contract fully complied with the provisions of that Act.[20] Petitioner has never challenged the validity of the Act, which comprehensively regulates both substantive and disclosure requirements pertaining to motor vehicle conditional sale contracts (and does *not* require the additional disclosures sought by Petitioner). He instead urged the California Supreme Court to *ignore* the Act's comprehensive scheme of regulation and

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[20]Petition for Writ of Certiorari, pp. 4-5.

judicially impose additional disclosure requirements rejected by the Legislature.

After reviewing in great detail Petitioner's objections to the use and disclosure of the Rule of 78's by Respondent, the California Supreme Court rejected his request for additional disclosures and concluded that:

> "[A]doption [of the Rule of 78's] as the prevailing rule in this state is . . . a legislative decision involving the weighing of policy matters as seen by legislators. Thus we would not be free to substitute our own views for those of the Legislature regarding the desirability of the rule even if plaintiff had sought a determination that it is invalid as a measure of the rebate because it is unfair to the consumer. The common law, which petitioner urges us to apply, is superseded when the Legislature acts. (*People v. Hickman* (1928) 204 Cal. 470, 479; *Lowman v. Stafford* (1964) 226 Cal. App. 2d 31, 39.)
>
> The Legislature has considered the rebate due a buyer on prepayment, the 'Rule of 78's' and the manner of its disclosure a number of times in recent years. (Rees-Levering Act: Stats. 1961, ch. 1626, § 4, pp. 3534, 3537; Stats. 1970, ch. 1003, § 1, pp. 1800, 1803; Unruh Act: Stats. 1969, ch. 625, pp. 1264, 1266; Stats. 1970, ch. 546, § 14, pp. 1040, 1043-1044; Stats. 1971, ch. 1061, § 1, pp. 2022, 2023.) In 1979, it enacted several measures to alleviate the harshness of the rule in certain transactions. Beginning in 1983, Rees-Levering contracts calling for payment in more than 62 months may not utilize the rule to calculate the amount of rebate due a buyer on prepayment. (Stats. 1979, ch. 805, § 19, p. 2880.) As of January 1, 1981, the contract must include the following statement: 'Because the refund [on prepayment] will be figured by the rule of 78's, the time when you prepay may affect the ultimate cost of credit under this agreement.'

(Civ. Code § 2982, subd. (a)(14)(A).) Thus it is clear that the Legislature is aware of the issue surrounding the 'Rule of 78's' and has taken such action as it deems appropriate. We would abuse judicial authority if we were to embellish legislative requirements." 28 Cal. 3d at 779-780 (footnotes and parallel citations omitted).

The California Supreme Court has consistently held that where the Legislature has acted within the bounds of its constitutional authority in regulating a certain field, the court will defer to legislative declarations of public policy. *E.g.*, *People ex rel. State Board of Medical Examiners v. Pacific Health Corp.*, 12 Cal. 2d 156, 161 (1938), *cert. den.*, 306 U.S. 633 (1939); *Werner v. Southern California Associated Newspapers*, 35 Cal. 2d 121, 129 (1950), *appeal dismissed*, 340 U.S. 910 (1951); *Wilson v. Walters*, 19 Cal. 2d 111, 115 (1941). The court acted according to that self-imposed rule of deference to the Legislature when it refused to require the additional disclosures sought by Petitioner.

B. The California Supreme Court Correctly Held That California Contract of Adhesion Principles Do Not Require the Additional Disclosures Sought by Petitioner.

In his Brief to the California Supreme Court, Petitioner conceded that a detailed mathematical explanation of the operation of the "Rule of 78's" would probably confuse more than inform consumers,[21] and instead urged the Cal-

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[21] Appellant's Response Brief in the California Supreme Court, p. 17. See also *Id.* at pp. 13-16.

This represented a substantial change in Petitioner's litigation posture. As noted in the Introductory Statement herein, Petitioner's Complaint alleged only that Respondent's use of the term "Rule of 78's" was "vague, ambiguous and uncertain" and thus "void, and unenforceable." Petitioner apparently did not consider the fact that, even if the court refused to enforce the rebate clause, he would still have been entitled only to a rebate according to the Rule of 78's, since that is all the Rees-Levering Act requires. Cal. Civ. Code § 2982(e).

Throughout the lower courts, Petitioner argued that Respondent should have disclosed at length and in detail the "meaning and implications" of the Rule of 78's. Only when this case reached the California Supreme Court did Petitioner abandon this contention and instead argue that Respondent should provide a "simple warning" of the Rule's effects or an "example" of its operation.

ifornia Supreme Court to require Respondent to include a "warning" in its contracts as to the effect of use of the rule.[22] In its opinion, the California Supreme Court emphasized that although such a simple "warning" might not be inconsistent with federal law, it is not required by contract of adhesion principles.[23] The court stated:

> "[W]e cannot conclude that a court may impose a requirement for such a warning under the law of adhesion contracts. The warning would not resolve any ambiguity in the meaning of the term 'Rule of 78's' and thus would not cure the only contract defect upon which plaintiff relies." 28 Cal. 3d at 775 (footnote omitted).

The court also stated:

> "[W]hile a statement in or appended to the contract to alert the borrower that the rule may operate to his disadvantage may be desirable and consistent with federal law, the law governing adhesion contracts does not compel such a warning." 28 Cal. 3d at 767.

The California Supreme Court thus held that, *even if* the disclosures sought by Petitioner could be made in a simplified manner which would not confuse consumers or detract attention from federal disclosures, such disclosures are not required under common law contract of adhesion principles.

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[22]Appellant's Response Brief in the California Supreme Court, pp. 15, 17.

[23]It is noteworthy that no California court has ever employed contract of adhesion principles to "rewrite" a contract to require additional terms or disclosures not originally included in the contract. The remedy in contract of adhesion cases has been limited to construing ambiguous terms against the stronger bargaining party or refusing to enforce exculpatory provisions not adequately disclosed to the consumer, or which were held to be contrary to public policy. *See, e.g., Steven v. Fidelity & Casualty Co.*, 58 Cal. 2d 862, 882-83 (1962); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263 (1966); *Tunkl v. Regents of the University of California*, 60 Cal. 2d 92 (1963).

III.

TWO OF THE THREE "QUESTIONS PRESENTED" BY PETITIONER ARE NOT PROPERLY BEFORE THIS COURT BECAUSE THEY WERE NOT RAISED IN THE LOWER COURTS.

Petitioner urges this Court to consider three questions. Only the first of those three questions, however, bears any resemblance to anything that was briefed, argued or decided in the lower courts.

This Court has consistently held that it will not review a question which was not raised in a proper and timely manner in the lower courts. *Cardinale v. Louisiana*, 394 U.S. 437, 438 (1969); *Crowell v. Randell*, 35 U.S. (10 Pet.) 368 (1836). Consistent with that principle, this Court should not consider the second and third questions raised by Petitioner.

A. Compliance With Federal Administrative Procedures Was Never an Issue in the Lower Courts.

In his Petition for Writ of Certiorari, Petitioner for the first time argues that the California Supreme Court somehow erred in reaching the federal preemption issue, and in so doing allegedly denied Petitioner the right to seek an interpretation of Regulation Z from the Board pursuant to "federal administrative procedures."[24]

Petitioner nowhere explains why he failed to raise this argument at any point in the lower courts. The federal preemption issue was fully briefed and argued before the California Supreme Court, and at no time did Petitioner ever contend the California Supreme Court lacked the authority

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[24]Petition for Writ of Certiorari, pp. 10-11.

to decide the issue. Indeed, even if properly raised, such an assertion would have been untenable.[25]

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[25]Petitioner's argument on this point is without merit. Apparently, Petitioner is of the view that the California Supreme Court should have ignored the question of federal preemption and decided the case solely on the basis of state law considerations, leaving the issue of federal preemption to be ultimately determined by the Board, which would allegedly guarantee Petitioner "vital procedural rights."

Unfortunately, Petitioner nowhere explains what "vital procedural rights" he is referring to. The statutes and regulations cited by Petitioner do not give him any procedural rights. 15 U.S.C. § 1610(a) is a general provision dealing with the preemptive effect of Truth in Lending on inconsistent state laws. There is nothing in section 1610 which establishes a "procedure" for determining whether state laws are inconsistent with Truth in Lending or Regulation Z. Section 1610 does not give any "procedural" rights to persons such as Petitioner.

15 U.S.C. § 1633 is also a general provision which authorizes the Board to promulgate regulations exempting a state from all requirements of Truth in Lending if the Board determines that the law of the state provides protections to consumers which are adequate and substantially similar to those of Truth in Lending. Section 1633 has nothing to do with this case. Not only does it not set up a "procedure" whereby a private party could seek a determination from the Board that particular disclosure requirements are not inconsistent with Regulation Z, section 1633 deals with the entirely distinct question of the circumstances under which a *state* will be granted a total *exemption* from Truth in Lending.

Petitioner also claims he is entitled to "procedural rights" under 12 C.F.R. § 226.6. Again, even the most cursory examination of this regulation shows that it has nothing to do with "procedures" for determining whether a state disclosure requirement is inconsistent with federal law. As relevant, section 226.6(b) simply *defines* what is an "inconsistent" state disclosure requirement.

Petitioner's cite to 12 C.F.R. § 262 (the Board's rules of procedure) is also inapposite. Those rules of procedure do not set up any "procedure" for an individual to apply to the Board for a determination that a state law disclosure requirement is inconsistent with federal law. Rather, they relate to the promulgation of regulations by the Board, and establish procedures for the Board to follow in taking action on matters which require the approval, authority, determination or permission of the Board. Petitioner has never contended that the Board failed to follow its own rules of procedure in promulgating Regulation Z and the Official Board Interpretation and Staff Interpretations relied on by the California Supreme Court.

(footnote continued on following page)

Because Petitioner failed to raise this issue in the lower courts, it is not a proper subject for review by this Court.

B. Petitioner Never Contended in the Lower Courts That a Ruling in Favor of Respondent Would Violate the Fifth or Fourteenth Amendments to the United States Constitution.

Petitioner also argues for the first time in his Petition that the ruling of the California Supreme Court would somehow deny him "due process."[26]

Petitioner again provides no explanation why his "due process" argument was not raised in the lower courts.[27] Because Petitioner failed to present this question in a timely and appropriate manner, it is not a proper subject for review by this Court.

C. Petitioner Did Not Comply With Supreme Court Rule 21.1(h).

Supreme Court Rule 21.1(h) provides that:

> "If review of the judgment of a state court is sought, the statement of the case shall also specify the stage

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It is possible that Petitioner has confused the provisions of the Truth in Lending Act and old Regulation Z with new procedures established by the Truth in Lending Simplification and Reform Act and revised Regulation Z. Revised Regulation Z § 226.28(a), discussed above, does create a new procedure whereby an interested party may request that the Board determine whether a state law requirement is inconsistent with the requirements of the Truth in Lending Simplification and Reform Act and revised Regulation Z. However, this new procedure was not in effect at the time this case was litigated in the California courts, and has no application to this case.

[26]Petition for Writ of Certiorari, pp. 11-12.

[27]In any event, there is no merit to Petitioner's argument that he was denied "due process." In his summary of "questions presented," Petitioner claims that the decision violated both the 5th and 14th Amendments to the Constitution of the United States. In his argument, however, Petitioner refers only to the 5th Amendment. Since it has long been established that the 5th Amendment applies only to actions of the federal government, *e.g.*, *Barron v. Mayor of Baltimore*, 32 U.S. (7 Pet.) 243 (1833), it is not clear how the California Supreme Court could have violated the 5th Amendment. Suffice it to say that Petitioner cites *no* authority whatsoever in support of this argument. So far as Respondent can determine, the argument is totally specious.

in the proceedings, both in the court of first instance and in the appellate court, at which the federal questions sought to be reviewed were raised; the method or manner of raising them and the way in which they were passed upon by the court; such pertinent quotation of specific portions of the record, or summary thereof, with specific reference to the places in the record where the matter appears . . . as will show that the federal question was timely and properly raised so as to give this Court jurisdiction to review the judgment on writ of certiorari."

Petitioner has made no attempt to comply with this rule, and clearly cannot do so as to his second and third questions, because those questions were never raised, briefed, argued or decided in the lower courts. Based upon Petitioner's failure to comply with the rules of this Court, this Court should decline to review the questions presented by Petitioner.

Conclusion.

As shown herein, Petitioner is not entitled to a writ of certiorari because the Petition herein raises no substantial federal question, the opinion of the California Supreme Court rests on adequate and independent state grounds and Petitioner failed to present his arguments in a timely and proper manner, and failed to comply with this Court's rules.

It is therefore respectfully submitted that this Court should deny the Petition for Writ of Certiorari.

Respectfully submitted,

SHEPPARD, MULLIN, RICHTER AND HAMPTON,
A Partnership including
Professional Corporations,
GEORGE R. RICHTER, JR.,
WILLIAM M. BURKE,
JEFFREY S. TURNER,
Attorneys for Respondent.

APPENDIX A.

Chronology of Federal Reserve Board Actions Concerning Prepayment Rebates and the Rule of 78's.

July 1, 1969	Truth in Lending Act became effective. The Act does not require prepayment rebate disclosure.
July 1, 1969	Regulation Z became effective. Section 226.8(b)(7) deals with prepayment rebate disclosure.
August 20, 1969	FRB issues Public Information Letter No. 70 discussing the Rule of 78's. Cons. Cred. Guide (CCH) ¶ 30,448 (1969-1974 Tr. Binder).
November 10, 1969	FRB issues Public Information Letter No. 177 discussing the disclosure of the Rule of 78's by name. Cons. Cred. Guide (CCH) ¶ 30,500 (1969-1974 Tr. Binder).
April 17, 1970	FRB issues Public Information Letter No. 307 stating that a creditor may disclose the Rule of 78's by name only and need not explain the formula. Cons. Cred. Guide (CCH) ¶ 30,532 (1969-1974 Tr. Binder).
May 25, 1970	FRB issues Public Information Letter No. 334 stating that section 226.8(b)(7) only requires identification of the Rule 78's by name. Cons. Cred. Guide (CCH) ¶ 30,389 (1969-1974 Tr. Binder).

July 29, 1970	FRB issues Public Information Letter No. 384 stating that a reference to the Rule of 78's by name is sufficient. Cons. Cred. Guide (CCH) ¶ 30,565 (1969-1974 Tr. Binder).
November 25, 1970	FRB issues Public Information Letter No. 427 stating that a reference to the Rule of 78's by name is preferable to citing the statute or reproducing detailed statutory language. Cons. Cred. Guide (CCH) ¶ 30,614 (1969-1974 Tr. Binder).
August 6, 1971	FRB issues Staff Letter discussing the different possible disclosures of the Rule of 78's and concluding that identification by name only is the best alternative. Cons. Cred. Guide (CCH) ¶ 30,725 (1969-1974 Tr. Binder).
December 15, 1972	FRB issues Staff Letter discussing the Rule of 78's. Cons. Cred. Guide (CCH) ¶ 30,916 (1969-1974 Tr. Binder).
December 1972	National Commission on Consumer Finance issues its final report following extensive hearings and studies, which recommends that creditors be permitted to rebate unearned finance charges according to the Rule of 78's. Report of the National Commission on Consumer Finance, *Consumer Credit in the United States* 40-41 (1972).

April 30, 1973	FRB promulgates Official Board Interpretation section 226.818, providing that identification of the Rule of 78's by name only is a sufficient disclosure. 38 Fed. Reg. 12202 (May 10, 1973).
April 30, 1973	FRB proposes to amend section 226.8(b)(7) to provide an additional rebate disclosure and requests public comment. 38 Fed. Reg. 12240 (May 10, 1973).
May 24, 1973	FRB issues Staff Letter discussing section 226.818, the Rule of 78's disclosure requirements and the district court opinion in *Bone v. Hibernia Bank*. Cons. Cred. Guide (CCH) ¶ 31,016 (1969-1974 Tr. Binder).
June 6, 1973	FRB issues Staff Letter explaining its reasons for issuing the Official Board Interpretation, section 226.818, and discussing the district court opinion in *Bone v. Hibernia Bank*. Cons. Cred. Guide (CCH) ¶ 30,983 (1969-1974 Tr. Binder).
July 12, 1973	FRB adopts proposed amendment to section 226.8(b)(7) with minor changes, effective January 1, 1974. 38 Fed. Reg. 19814 (July 24, 1973).
May 14, 1974	FRB issues Public Information Letter No. 794 discussing the Rule of 78's. Cons. Cred. Guide (CCH) ¶ 31,116 (1974-1977 Tr. Binder).

April 21, 1975	FRB issues Public Information Letter No. 885 regarding the Rule of 78's. Cons. Cred. Guide (CCH) ¶ 31,211 (1974-1977 Tr. Binder).
February 4, 1977	FRB issues Official Staff Interpretation FC-0044 regarding the disclosure of the Rule of 78's. Cons. Cred. Guide (CCH) ¶ 31,535 (1974-1977 Tr. Binder), published for public comment, 42 Fed. Reg. 9385 (February 16, 1977).
April 27, 1977	FRB proposes an amendment to section 226.8(b)(7) to simplify the prepayment rebate disclosures by eliminating the requirement that the rebate method be "identified." Various possible disclosures are discussed, and public comments are solicited. 42 Fed. Reg. 23516-17 (May 9, 1977). This amendment was not adopted by the Board. The change proposed by the Board was instead made in revised Regulation Z issued under the Truth in Lending Simplification and Reform Act.
March 22, 1977	FRB issues Public Information Letter No. 1168 discussing the use of the Rule of 78's to identify the rebate provided under state law. Cons. Cred. Guide (CCH) ¶ 31,561 (1974-1977 Tr. Binder).
March 31, 1980	The Truth in Lending Simplification and Reform Act was signed into law, to become fully effective April 1, 1982. Pub. L. No. 96-221, Title VI.

September 24, 1980 FRB issues Staff Letter concluding that state laws (whether statutory or judicially imposed) requiring disclosure of the meaning and implications of the Rule of 78's are inconsistent with Regulation Z.

APPENDIX B.

Listing of All Parent Companies, Subsidiaries and Affiliates of Respondent Security Pacific National Bank (as Required by Supreme Court Rule 28.1).

Name	State of Incorporation
Security Pacific National Bank	A National Banking Association
Security Pacific International Bank	§ 25(a) of the Federal Reserve Act
First Small Business Investment Company of California	California
Equitable Deed Company	California
Security Pacific Equipment Finance (Europe) Inc.	Delaware
Security Pacific National Leasing, Inc.	Delaware
Security Pacific Equipment Leasing, Inc.	Delaware
Security Pacific Commercial Leasing, Inc.	Delaware
PNB Securities Corp.	California
Security Pacific Lease Finance (Europe) Inc.	Delaware
Security Pacific Overseas Corp.	§ 25(a) of the Federal Reserve Act.
Security Pacific Do Brasil S/C Ltda. (Formerly Security Pacific Administracaco e Servicos Ltda.)	Brazil
Security Pacific Overseas Investment Corporation	Delaware
Security Pacific Bank (Panama) S.A.	Panama
The Bank of Canton, Limited	Hong Kong
The Bank of Canton (Nominees) Limited	Hong Kong
Canton Pacific Finance Limited (Formerly Canbank Finance Limited)	Hong Kong
The Bank of Canton Ltd. Macao	Macao
The Bank of Canton (Nominees) Limited Singapore	Singapore
Security Pacific Australia Limited	Australia
Security Pacific International Finance Limited	Canada
Sectras	Delaware
Eden Isle, Inc.	Delaware
Lakeside Utilities, Inc.	Louisiana
Lakeside Marketing Co.	Louisiana
Golf Course, Inc.	Louisiana

Name	State of Incorporation
Pacific Southwest Realty Company	Delaware
SEPAC Acceptance & Lease Services, Inc. (Formerly SEPAC Lease Systems, Inc.)	Delaware
Security Pacific Southwest, Inc.	Delaware
Security Pacific Midwest, Inc.	Delaware
The Bankers Investment Company	Kansas
Central Plains Insurance Company, Inc.	Kansas
Central Plains Life Insurance Company, Inc.	Kansas
Stenstron & Burke, Inc.	Kansas
Sandia Appraisal Co., Inc.	New Mexico
BIC Loans of Cheyenne, Inc.	Wyoming
Security-First Company	California
Security Pacific Capital Corporation	Delaware
Security Pacific Clearing & Services Corp.	Delaware
Security Pacific Corporation	Idaho
Security Pacific Finance Corp.	Delaware
SP Escrow Service, Inc.	Delaware
Security Pacific Finance Corp.	Idaho
SP Insurance Agency, Inc.	Delaware
Security Pacific International Leasing (Europe) Inc.	Delaware
Security Pacific Leasing Corporation	Delaware
Security Pacific Leasing Services Corporation	Delaware
Security Pacific Mortgage Corporation	Delaware
Equity Management Inc.	Colorado
Equity Management of Hawaii, Inc.	Hawaii
The Hasurf Corporation	Hawaii
Kassler Mortgage Service, Inc.	Washington
RT Service Co.	California
The BougainVille Corporation	Hawaii
The Interisland Group, Inc.	Hawaii
Security Pacific Mortgage of Hawaii, Inc.	Hawaii
Security Pacific Escrow, Inc.	Colorado
S.P.M.C. Escrow, Inc.	Delaware
Loan Closing Services, Inc.	Delaware
Rocky Mountain Escrow, Inc.	Delaware
Security Pacific Venture Capital Advisory Corporation	Delaware
Security Pacific Overseas Finance, Inc. (Formerly Security Universe Finance Corporation)	Delaware

Name	State of Incorporation
Security Pacific Finance Limited (Formerly Market Credit Limited)	England
Japan Security Pacific Finance Company, Limited	Japan
Security Pacific Credit (Hong Kong) Limited (Formerly Security Universe (Hong Kong) Limited)	Hong Kong
Security de Espana, S.A.	Spain
Security Pacific Investment Managers, Inc.	Delaware
Security Pacific Financial Services, Inc.	Delaware
Security Pacific Financial Services International Ltd.	Delaware
American Finance System Incorporated	Delaware
General Fidelity Life Insurance Company	Virginia
AFS Management, Inc.	Delaware
Service Supply Corporation	District of Columbia
Rediscount Corporation of America	Virginia
Rediscount Corporation of Louisiana	Louisiana
American Finance Management Corporation	Delaware
Dealers Credit, Inc.	Delaware
Security Pacific Finance Corp.	Arizona
Security Pacific Finance Corp.	Colorado
Colorado Springs Security Pacific Industrial Bank	Colorado
Security Pacific Industrial Bank	Colorado
Security Pacific Finance Corp. of Granite State	Connecticut
Security Pacific Corp. of Illinois	Delaware
Security Pacific Corp. of Kentucky	Delaware
Security Pacific Finance Corp. of Delaware	Delaware
American Finance Corporation of Frederick	Delaware
Security Pacific Finance Corp. of New Hampshire	Delaware
Security Pacific Finance Corp. of Florida	Florida
Security Pacific Finance Corp.	Florida
Security Pacific Finance Corp.	Georgia
Security Pacific Finance Corp.	Indiana
Security Pacific Finance Corp.	Maryland
American Finance Corporation of Maryland	Maryland
American Finance Corporation of Connecticut	Mississippi
Security Pacific Finance Corp.	New Jersey
Security Pacific Finance Corp. Credit Services, Inc.	New York
Security Pacific Finance Corp.	New York
Security Pacific Finance Corp. of Utica	New York
Security Pacific Finance Corp. of Ohio	Ohio

Name	State of Incorporation
Security Pacific Finance Corp.	Ohio
Security Pacific Consumer Discount Company	Pennsylvania
Security Pacific Finance Corp.	Vermont
Security Pacific Finance Corp.	Virginia
Security Pacific Finance Corp. of Louisiana	Virginia
First Fenwick Mortgage Corporation	Virginia
Security Pacific Finance Corp.	West Virginia
Security Pacific Finance Business Center, Inc.	California